THE COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATION AND ENERGY

Investigation by the Department of Telecommunication and Energy on its own Motion into the Impacts of of Default Supply Procurement Alternatives on Retail Competition	)	**D.T.E. 04-115**

INITIAL COMMENTS OF THE COMMONWEALTH OF MASSACHUSETTS DIVISION OF ENERGY RESOURCES

Dated: January 10, 2005

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I. Introduction

The Massachusetts Division of Energy Resources ("DOER") provides these comments in response to the December 6, 2005 Request For Comments issued by the Massachusetts Department of Telecommunication and Energy ("Department" or "DTE") opening an investigation into the provision of Default Service (hereafter DS). As stated in the Request For Comments, the Department opens this docket as part of an effort to ensure that:

> [t]he Department remains committed to maintaining and improving a sound framework for a competitive retail market for all customers…[and to] periodically review the effectiveness of our policies and modify them when circumstances warrant.

The DOER commends the Department for continuing to provide timely oversight of the evolution of a competitive Market for electric power in Massachusetts and welcomes this opportunity to present its views on the provision of Default Service in a manner that is compatible with the development of an efficient competitive retail Market.

II. Executive Summary

DOER notes that policies on DS should reflect the underlying policy direction and mandates of the Electric Restructuring Act. Admittedly these must be interpreted in light of the reality of 2 million customers on DS for the foreseeable future, which is a great many more than it seems was anticipated at the time the Act created DS. However, DOER continues to believe that the Department's goal in establishing DS policies should be to ensure that the manner in

which Default Service is provided is compatible with the development of an efficient competitive Market in Massachusetts.

Overall, DOER recommends that the Department retain a standardized method of DS procurement that strictly prohibits distribution companies from engaging in "strategic" behavior that is designed to "beat" the Market. The contract term, frequency and volume of these procurements should remain regular and predictable, transparent to competitive wholesale and retail suppliers and to retail customers. The most important aspect of the current methodology to retain is the one-year contract term for any procurement. Finally, the Department should implement a unified procurement process that would produce a uniform, or very similar price, for all DS customers statewide, a price that would change at the same time for all these customers. Because this would be a larger supply requirement than those under the current system, the frequency and volume of these might be changed from the current practice (of 50% partial supply, procured semi-annually), but those changes should not alter the one-year contract term.

All distribution companies should procure DS in the same way using **predictable** and **transparent** methods. Procurements of DS that are timed or otherwise designed to capitalize on Market opportunities are not the proper domain of the distribution company. These are the proper domains of competitive suppliers. Such suppliers are established to take and mange risks for their customers. They marshal unique expertise to accomplish this objective and are properly rewarded by the Marketplace for the success or failure of the efforts. If ever there is any basic distinction to be made between procurement by a regulated distribution company and competitive power suppliers, it is this. If distribution companies try to beat the Market they run the risk of either of two undesirable outcomes. They succeed; in which case the low prices they

achieve will effectively prevent competitive suppliers from competing with DS. Or, they fail, in which case they run the risk of imposing unnecessarily high DS prices on customers.

By predictable and transparent methods, we mean a set of publicly known and consistent practices that include a pre-determined frequency (i.e. without altering the timing of any purchase for what the company might think are "strategic" reasons), purchasing a consistent portion of the total required supply during each procurement event, using standard and consistent contract terms, using standard and consistent advertising and bidding requirements, etc. In addition, the criteria for bid selection and award must be straightforward and known in advance by all bidders to minimize the risk that subsequent prudence review would revoke an award. To date, the Department's DS procurement policies and the behavior of distribution companies have largely adhered to these principles. We strongly urge that these principles be maintained in any version of DS procurement that may be adopted by the Department now or in the future.

The very name "Default Service" suggests what the legislature intended it to be: a temporary source of power for customers who were between competitive suppliers or otherwise not able to obtain competitive supply. The term of "not less than six months" suggests they meant for it to be more stable than real time prices but that it should change regularly to reflect Market conditions.[1] The legislature may not have then anticipated the current reality: that DS would become a source of supply for the majority of smaller customers.[2] With few or no competitive alternatives, DS may be the only service available to these customers for an extended period of time.

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[1] G.L. c. 164, sec. 1B(d).

[2] The term "smaller customer" as referenced here and in the Department's Request for Comments should be regarded as synonymous with residential and small commercial retail customers.

III. General Comments

DS procurement policies should be designed to provide customers with a reliable source of power at a stable price that reflects underlying Market conditions while avoiding, or at least minimizing, interference or conflict with the development of a competitive retail Market. Whatever approach is ultimately selected by the Department, the procurement methodology should be fully transparent, administered uniformly across utility franchise areas, and specified in a way that precludes exercise of discretion by the procurement agent. After-the-fact prudence reviews should therefore be unnecessary.

Some might suggest that experience with DS to date has shown that, even with predictable and transparent DS procurements, competition has not developed for smaller customers. Yet, there are at least two reasons why it would be premature to conclude that competitive options cannot or will not develop for these customers. First, below Market Standard Offer pricing for many of these customers has clearly been a deterrent to competition and reduced customers' motivation to seek competitive supply. Second, different prices for DS in different service territories has meant that there is no single price against which competitive suppliers can market their products. The Market has been balkanized to the point where competitive suppliers cannot identify opportunities to efficiently capture significant Market share.

These circumstances only reinforce the importance of maintaining procurement policies that minimize interference with the legislation's ultimate intent: to enable these customers to choose retail competitive supply if they would like to do so.

There are several reasons why DS procurement would be best implemented through a unified procurement for all of the state's DS customers. The main reason is that it would eliminate most

differences between the DS prices paid by customers in one distribution company's service territory and another.[3] There are several benefits from a uniform DS price. First, it avoids the barrier to retail competition created by differences in DS prices between service territories. These differences are a barrier to retail competition because, for the foreseeable future, the single biggest competitor to a supplier interested in selling retail power supplies is DS. Differences in DS prices from territory to territory (not related to locational marginal pricing but to the timing or size of the distribution company procurements) make a supplier's product more competitive in some territories than others. The supplier cannot compete across the entire state with equal vigor, cannot justify investments in advertising and marketing in equal amounts across the state. The Commonwealth is already a relatively small market for a competitor, and further balkanization only worsens that disadvantage.

Another benefit of a uniform price statewide for DS is that it will avoid the advantages gained by some DS customers whose distribution company happens to issue its procurement at a time when the Market conditions are very favorable, and customers in another territory who, but for the accident of poor timing of their distribution company's procurement, are left paying more for DS. While it is possible, even likely, that over time these differences would tend to even out, there is a serious "appearance" problem: disadvantaged customers will find it hard to understand why they are paying more for the same service. This appearance problem becomes a reality for customers who are only on DS for short periods and, because of the anomalies of their distribution company's procurement schedule, may gain a windfall advantage or pay more than others on DS for that same period.

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[3] LMP differences should continue to be determined on a service territory basis. These will make for slight differences in DS prices.

Finally, a statewide procurement resolves concerns about the administrative efficiency of any method of DS procurement. Statewide procurement solves this problem by achieving the most efficient administrative costs for all distribution companies and allowing those costs to be allocated fairly, on the basis of load, to each company.

Responses to Specific Questions Raised by the Department:

1. Number of solicitations

Would smaller customers be better served if power supply for default service is procured using a portfolio of more than two solicitations? Please discuss the advantages and disadvantages of increasing the number of solicitations used to procure default service supply?

Response:

DOER submits that the current structure of DS procurement properly serves DS customers by striking an appropriate balance between providing for a reasonable amount of price stability while still reflecting changes in Market conditions. In the Department's earlier proceeding on DS, DOER submitted a proposal for the use of quarterly procurements of one-eighth partial requirement contracts that would each last for a term of two years. At the time, many criticized this proposal.[4] While DOER does not believe all of these criticisms were well founded (for example we fully believe that the cost of these procurements would be no greater than today's costs because they would become routine), DOER recognizes that some of the concerns cited have validity. At that time, the Department agreed with many of DOER's arguments in principle but chose to order a simpler version of the staggered, overlapping contract method proposed by NSTAR. Over time, we have observed the operation of this method. We have come to recognize that this method strikes a fair balance between competing policy goals and operates efficiently.

[4] The Department summarized these criticisms in its Order. It said some argued that the proposal would be "unduly complicated, unnecessarily burdensome and has the potential to increase default service prices by eliminating purchase economies." It said others argued the proposal would insulate default service prices from Market conditions to the detriment of the competitive Market. Finally, it said still others argued a default service price that,

Semi-annual procurements provides for a regular updating of the price in a manner that keeps it reasonably reflective of prevailing conditions in the short-term wholesale Market. Those conditions include substantial, sustained changes in fuel prices; changes in wholesale Market rules that effect the cost of delivering power such as locational marginal pricing and installed capacity charges; and, substantial changes in the infrastructure of power plants (through retirements or construction) and transmission lines (through expansion) that likewise effect the long-run cost to deliver wholesale power.

The purchase of one-half of a company's requirement at a time is an improvement over the previous method of purchasing 100% of the company's requirements at a time. First, it moderates overall DS price changes by blending two contracts one which reflects market conditions as these were anticipated a year earlier and one which represents market conditions anticipated a year in advance. Because it reduces the overall size from 100 percent to 50 percent for any single procurement, more companies are able to compete to provide this power. It also is better in that companies do not have to withhold commitments of large amounts of power to the competitive market in order to be able to bid in the DS competitions. It is also administratively easier than quarterly procurements. Therefore, DOER recommends that the Department leave the current frequency and term requirements unchanged.

2. Contract Term

Would smaller customers be better served if power supply for default service was procured for a term longer than twelve months? Please discuss the advantages and disadvantages of using supply terms greater than twelve months. In particular, please discuss:

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in any given month, would be the average of eight contracts "blended" together, would "always be out of step with

a. *whether longer contract terms are likely to produce lower prices,*

b. *how such an approach would affect price certainty and Market efficiency, and*

c. *how such an approach could be tailored to accommodate customer migration to competitive supply.*

Response:

Notwithstanding its proposal of two years ago, DOER does not now believe that contract terms of longer than one year for DS supply are necessary or advisable. Because contracts over longer terms would inevitably have to reflect the cost of greater fuel price risk, these are almost certainly going to increase the long-run price of DS. DS customers receive sufficient protection against short-term Market volatility from one-year contracts, especially when half of these supplies are turned over and re-priced semi-annually.

Contracts of one year in duration can readily be hedged to eliminate fuel price risk in the current and in the reasonably foreseeable future wholesale power Market. Because fuel prices are so difficult to anticipate beyond more than one year, such hedging would be more difficult and therefore more expensive to accomplish with two year contracts. One year contracts allow customers to receive the benefit of predictable prices for a reasonable period of time at a reasonable cost. These also avoid requiring the supplier to include a substantial premium for the risk that unexpectedly large numbers of customers will migrate to competitive suppliers due to unforeseen regulatory changes or changes in Market conditions in the second year of a contract.

DOER believes it should be the province of competitive suppliers to price and provide supply contracts that hedge long-run fuel price risk and other potential long-run Market changes.

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the Market," and is particularly problematic for competitive suppliers when Market prices rise. DTE Order 02-40-B

Indeed, it is the strategic ability of competitive suppliers to foresee and efficiently absorb these risks that will likely be one of the most important ways they will distinguish their products from the regulated DS product.

Every DS bid must include some premium to anticipate customer migration. It is likely that a one year contract term will include a very small premium because most changes in Market or regulatory condition that are large enough to suddenly accelerate customer migration, can be reasonably foreseen and efficiently priced. However, as the contract term increases this premium necessarily increases dramatically. It is increasingly difficult to anticipate such changes in fuel prices and Market conditions beyond one year and much more difficult to do so for three years or more. (While some fuel sources have very stable fuel costs (e.g. nuclear, coal, renewables) and become highly desirable to wholesale suppliers seeking to minimize fuel price risk, these power sources remain exposed to other risks such as increased environmental compliance costs, transmission expansion that decreases the locational value of a power plant, and regulatory changes.) Contract terms of two or more years will necessarily include higher risk premiums and be more expensive for DS customers over the long run.

Some might suggest that longer-term contracts would facilitate the financing and construction of power plants and thus actually result in lower prices as a result of greater competition among wholesale suppliers. DOER does not believe that changes in terms from one to two or three years would have an appreciable effect on the ability of potential DS suppliers to obtain financing and therefore would have no discernable effect on lowering DS prices over the long-run.

Two years ago DOER argued that there would be value to customers in being able to compare the prices revealed in the most recent DS procure of a one-eighth supply for two years

with the price offered by competitive suppliers for a two-year contract. Upon reflection, DOER now believes this is largely a theoretical advantage and not one likely to be realized in practice. It would require a high degree of sophistication on the part of shopping retail customers to do the research necessary to make such a comparison and to use it effectively in negotiating with competitive suppliers. It also isn't necessarily a relevant comparison if a customer's choice is between staying on DS or going to a competitive supplier, since that two-year strip of DS prices would only influence one-eighth of the DS supply. If the customers primary comparison is between competing suppliers, they are likely to ignore the most recent DS contract and simply compare offers from several suppliers.

If DS procurements were required for terms longer than one year, some might argue that the premium associated with migration risk over a longer term would justify restraints on customer migration (e.g. a limiting the percentage of DS customers that would be allowed to migrate to competitive supply during any given year or contract term). Since the advent of restructuring, MA has had a policy that customers on regulated forms of generation service should face as few restraints as possible on their ability to move competitive suppliers. While large customers have proven capable of gaming the DS offering to their advantage through strategically timing going on and off DS, residential customers are much less likely to have the ability and opportunity to capture such advantages. No restraints on customer movement to competitive suppliers should be imposed merely to offset the inherent risk premiums that go along with requiring longer-term DS contracts.

3. Separate or Joint Procurements

Would smaller customers be better served if power supply for default service was procured on a statewide basis? Please discuss the advantages and disadvantages of using a statewide approach to default service procurement.

Response:

DOER believes smaller customers would be better served through unified or coordinated procurements of DS supply. The current method of individual procurements of DS by each distribution company can result in material differences in the price of DS from one service territory to another. The timing or size of a distribution company's procurement of DS can be substantially affected by short-term changes in Market conditions (such as differences in fuel prices or in the availability of particular generation sources).

As discussed earlier, these price differences create a serious barrier to retail competition. Differences in DS prices from territory to territory (not related to LMP but to the timing or size of the distribution company procurements) make that supplier's product more competitive in some territories than others. The supplier cannot compete across the entire state with equal vigor and can not justify investments in advertising and Marketing in equal amounts across the state. Competitive suppliers are forced to tailor their offers to compete with different DS prices in different service territories, or even give up on competing in a territory until its DS price increases. Massachusetts is already a relatively small Market for a retail competitor. Further balkanization as a result of different DS prices in different territories only worsens that disadvantage. This balkanization is a serious obstacle to entry by competitive retail suppliers.

Also, uniformity of DS pricing would eliminate the apparent advantage gained by some DS customers who's distribution company happens to conclude its procurement at a time when the Market conditions are very favorable in comparison to the DS customers in another territory who, but for the accident of poor timing of their distribution company's procurement, are left paying more for DS. While it is possible, even likely, that these differences would tend to even out over time, there is still a serious "appearance" problem: temporarily disadvantaged customers find it hard to understand why they are paying more for the same service. There is also a real problem for customers who are only on DS for short periods and, because of the anomalies of their distribution company's procurement schedule, May gain a windfall advantage or pay more than others, on DS for that same period elsewhere in the state.

Unified or coordinated DS procurement could reduce the visibility and idiosyncrasies of individual DS procurements by each distribution company. This too could have a beneficial effect on entry by retail competitors since they tend to view the dominant role of the distribution company in providing DS as a barrier to entry.

The mechanics of a unified or coordinated procurement should be fairly easy for the distribution companies to develop. The result of these procurements would still be a partial requirements contract between the winning supplier and each distribution company. The entity conducting the procurement would not take title to the power or otherwise have any consequential role in the transaction. The Manager of the unified procurement would receive the requirements from each distribution company for a given contract period, aggregate these into a single request for bids, and make clear in the request that the winning bidder will execute individual contracts with each distribution company using a standard form contract. The Manager would evaluate the bids and select the winner according to criteria agreed upon in

advance by the distribution companies and approved by the Department. The Manager could be selected jointly by the distribution companies or could be appointed by the Department. The procedures to be used by the Manager could be negotiated, in the first instance, by the distribution companies with any unresolved disputes resolved by the Department in approving the request. The costs of the manager's services could be paid by the distribution companies proportionate to their load, and the recovery of those costs included in the retail price of DS. Unified procurement has been implemented by several other states, including Maine and New Jersey. (See Attachment 1 for a description of their practices and results to date.)

4. Procurement Method

Would smaller customers be better served if power supply for default service was procured using an auction process (e.g. descending clock) rather than through requests for proposals? Please discuss the advantages and disadvantages of using an auction process to procure default service. In particular, please discuss whether using an auction is likely to produce lower default service prices.

Response

The so-called 'descending clock' auction has been used in New Jersey to procure the equivalent of DS supply for all customers across the state. This method encourages aggressive bidding by wholesale suppliers and will therefore tend to produce prices that are reflective of Market conditions. The auction process can be used in any combination of full or partial requirements and short or long contract term. Generally it is useful if there is a desire to achieve a uniform winning price while maintaining the option of having more than one winning bidder.

(See Attachment 1 for a brief description of the auction process used in New Jersey and the results achieved there so far.)

5. The Case for Renaming Default Service

Although the term 'default service' is statutory, G.L. c. 164, § 1, it has confused some customers because of its unintended suggestion of nonfeasance in performing a legal or contractual obligation. Is there some better or more descriptive term that ought to be used by the distribution companies on and after March 2005?

Response:

The name "Default Service" carries a stigma of non-performance and leads to confusion in the perceptions customer have of what the service option is intended to represent. It would be preferable to call this option "Basic Service" or "Generation Service" or "Provider of Last Resort Service" to reinforce the no-frills, non-brand nature of the service.

Respectfully submitted,

Commonwealth of Massachusetts
Division Of Energy Resources

By its attorney,

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Maine and New Jersey Default Supply

Procurement Approaches and Experiences

Compiled by Plexus Research, Inc.[5]

Overview

Experiences in Maine and New Jersey offer valuable insights into procurement of default supply for residential and small non-residential customers.[6] Approaches pioneered in both states seek to obtain prices that closely reflect Market conditions and reduce the role of the regulated delivery company in default supply procurement. However, the procurement approach adopted in the two states is quite different—Maine relies on Requests for Bids issued by the Maine Public Utilities Commission (MPUC) for retail supply within each utility service territory while NJ uses a descending clock auction to meet all utilities' respective default supply requirements in a single process. Neither state has seen a significant migration of residential or small non-residential customers to competitive retail contracts since their respective Market openings.

Maine's Standard Offer Procurement Experience

Background

Maine's 1997 restructuring legislation provides for a one type of default supply service— Standard Offer Service and requires that it be available to all customers who do not otherwise have a retail supplier.[7] Standard Offer Service is full-requirements, retail[8] power supply option that is procured through a competitive bidding process administered by the MPUC, a seemingly unique extension of traditional regulatory authority. The law requires that the MPUC conduct a periodic bidding process to procure Standard Offer supply for customers within each utility service territory. The MPUC has substantial flexibility to set procurement terms and discretion to accept or reject bids. In the event that the MPUC rejects all bids in a procurement cycle, it has the authority to order the applicable distribution utility to purchase Standard Offer supply in the wholesale Market. Chapter 301 of the MPUC's rules governs Standard Offer and the associated supply procurement process. Since its initial bid cycle for supply in March 2000, coincident with the opening of retail competition in Maine, the MPUC's bid process has evolved as experience has been gained.

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[5] This information was compiled entirely from publicly available documentation.
[6] Called 'Standard Offer Service' and 'Basic Generation Service,' respectively, by Maine and NJ.
[7] 35-A M.R.S.A. § 3212.
[8] The arrangement is considered "retail" because the regulated distribution utility no longer takes title to the power.

Retail switching among residential and small non-residential customers in Maine was 1% or less for Central Maine Power and Bangor Hydro and 14% for Maine Public Service (anomalous conditions exist – see discussion below) as of December 1, 2004.

Principles, Policies and Approach

The MPUC's stated position is that the purpose and design of Standard Offer should reflect the prevailing competitive retail Market. As a result of its own assessments of retail Market conditions, the Commission's Standard Offer approach treats residential and small non-residential customers quite differently from larger customers. The MPUC's December 2002 Standard Offer Study concluded,

> *"In Market sectors where retail competition has not developed, such as for residential and small commercial customers, we concluded that standard offer service should be used to capture competitive Market benefits for customers. In these sectors, standard offer service should not be designed to force customers into a Market, and prices should not be deliberately set above-Market in the hope that suppliers will respond and effective competition will develop."*[9]

However, the MPUC has adopted the view that, despite lack of progress to date, retail competition in the small customer segment remains achievable and should be supported.

Procurement Mechanics

The MPUC is fully empowered to conduct the bidding and authorized to respond to certain situations in ways that utilities acting in the procurement role could not, e.g., the MPUC can direct utilities to purchase power in the wholesale Market when retail bids are deemed to be unacceptable. Moreover, the MPUC enjoys significant flexibility in specifying bid requirements and contract terms in its role as Standard Offer supply procurement administrator.

Maine recognizes several Standard Offer classes for bidding purposes—residential and small non-residential, medium non-residential, and large non-residential. Kilowatt demand break points for these classes vary somewhat by utility but are generally indicated by those of Central Maine Power (CMP):

- Less than 25 kW for residential and small non-residential
- 25 – 400 kW for medium non-residential
- Greater than 400 kW for large non-residential

Duration of the Standard Offer obligation varies by Standard Offer class but has been three years for accepted small customer bids when current Market conditions appear favorable to the MPUC. Standard Offer bids may be for a portion of the requirements of a class but must be in multiples of 20% up to 100%. Rules specify that bids must be selected at least 45 days prior to the supply

[9] Maine Public Utilities Commission, Annual Report on Electric Restructuring, December 31, 2002, Appendix C, p. 49.

obligation date. Recent bid solicitations for the small customer class allow bidders to propose a one-year term for the entire class; a blend of one-, two-, and three-year terms, each for one third of the total class requirement; or a similarly blended structure over five years.

Standard Offer providers are allocated a fixed percentage amount for expected uncollectable standard offer revenue ('customer bad debt') that remains unchanged for the term of supply service.

Numerous discretionary decisions have been made by the MPUC during each procurement cycle that reflected the agency's particular view of the Market, likely FERC actions, and expectations about the future.

Results

Year 1 – In the initial bid cycle for supply service beginning in March 2000, the first set of Requests for Bids (RFBs) was issued in August 1999. The Commission accepted a bid from Atlantic Energy to supply CMP's residential and small non-residential class for a period of two years. Two bidders were also selected to supply Maine Public Service's (MPS) medium non-residential class. Bids for other classes were rejected and the MPUC directed CMP and Bangor Hydro Electric (BHE) to procure power supply in the wholesale Market and to provide the Standard Offer Service needed.

Year 2 – The second bid cycle, for supply beginning in March 2001, began with an RFB issued in October 2000. Due to expectations on the part of the MPUC regarding the FERC's handling of ICAP, all bids received for CMP and BHE classes were rejected and the utilities were again directed to pursue wholesale arrangements. Bids were accepted from WPS Energy Services for the MPS territory, reflecting the area's isolation from ISO-NE and concomitant insulation from pending ICAP decisions.[10]

Year 3 – The third bid cycle, for supply beginning in March 2002, began in the summer of 2001 when wholesale Market prices had declined substantially. Because a significant number of medium and large non-residential customers had migrated to Market contracts by this time, the MPUC decided to conduct bidding for the residential and small non-residential class only. This round produced significantly improved retail bids and the MPUC selected CPS Maine as the provider for both CMP and BHE for a three-year period to insure reasonable and stable prices for small customers. In bid cycles for the medium and large customer classes later in 2002, the MPUC chose Select Energy for a shorter one-year term in recognition of the increasing competitiveness of these segments in the retail Market.

Current cycle – In December 2004, the MPUC accepted bids for Standard Offer supply to the residential and small non-residential class for both CMP and BHE beginning in March 2005 for a one-year term. Increases of 40% in the bid prices from those accepted three years earlier reflect current wholesale energy prices. The MPUC also accepted bids for a portion of the load from

[10] Additionally, WPS acquired the generating assets of MPS and was generally unable to sell the output either into ISO-NE or Canada.

March 2006 – February 2008, with the remaining requirements to be procured prior to the beginning of the new supply periods. Because of its unique supply characteristics, MPS customers continue receiving Standard Offer supply from WPS Energy Services through December 2006.

New Jersey's Basic Generation Service Procurement Experience

Background

New Jersey's Electric Discount and Competition Act (1999)[11] introduced retail electricity competition (actually began in November 1999 after a delay) and specified how Basic Generation Service (BGS) was to be provided over a four-year transition period, which ended in August 2003. Each electric distribution company (EDC) was required to purchase power supplies for BGS at prices "consistent with Market conditions." While NJ utilities were encouraged to divest generation, affiliates of utility holding companies were not precluded from participation in bidding. Results of BGS procurements by the EDCs were and continue to be subject to prudence review by the NJ Board of Public Utilities (NJBPU).

Initially, each EDC conducted its own wholesale bidding process for BGS power supply, issuing RFPs and submitting bid awards to the NJBPU for approval. However, for the procurement cycle for Year 4 of the Transition Period (August 1, 2002 through July 31, 2003) a descending clock auction[12] for obtaining BGS power supplies was jointly proposed by the four NJ EDC's.[13] The Year 4 auction, and subsequent Post-Transition year auctions, have been conducted and managed by a consultant (National Economic Research Associates). The NJBPU also retained its own consultant (Charles River Associates) beginning in September 2001 to observe and assess the auction process against the NJBPU's stated certification criteria.

In the NJ BGS auction the total load of all four EDC's is bid out in a single auction process. Total BGS load has been as high as 18,000 megawatts.

Retail switching by residential customers in NJ has been almost nonexistent, as only 0.05% of accounts had migrated to Market contracts as of December 27, 2004.

Principles, Policies and Approach

The NJBPU considers the auction process to be "simulating Market conditions,"[14] and auctions are carefully designed to mimic Market activity. Certification of auction results by the NJBPU

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[11] N.J.S.A. 48:3-49 et seq.
[12] Also known as a simultaneous, multi-round, descending clock auction
[13] Public Service Electric & Gas Company (PSE&G), Jersey Central Power & Light (formerly known as GPU Energy), Atlantic City Electric Company (ACECO) d/b/a Conectiv Power Delivery, and Rockland Electric Company (RECO).
[14] NJBPU Order in Docket Nos. EX01110754 and EO02070384, issued 11/20/02, p.4.

involves almost no discretion, emphasizing procedural aspects of the auction process, including the following (partial list)—[15]

- bidders had sufficient information to prepare for the auction;
- no procedural problems nor errors were observed during the auction;
- all communication protocols were followed;
- no hardware or software problems with the auction and communications systems were observed;
- no security breaches were observed during the auction process;
- all guidelines for setting the auction volume were followed;
- there was no evidence of confusion nor misunderstanding on the part of the bidders, nor were any complaints received from the bidders;
- the auction was carried out in a fair and transparent manner.

Procurement Mechanics

NJ's descending clock auction entails a highly streamlined process for soliciting indicative bids, followed by multiple, "lightning" rounds of revised bids in a compressed time frame, generally a few days. Two separate auctions are staged—a fixed price (FP) auction for residential and small business customers and an hourly energy price auction for larger commercial and industrial customers (CIEP, formerly know as HEP). Within each auction, numerous trenches of each EDC's requirements are created for bidding purposes, where a tranche is a fixed percentage share of the BGS load.[16] A tranche in the BGS-FP auction is equivalent to approximately 100 megawatts and a tranche in the BGS-CIEP approximately 25 megawatts. Prior to the auction, a minimum and maximum starting price is issued by the auction manager, forming the basis for EDC-specific starting point prices and indicative bids. The auction process begins with bidders specifying the number of tranches they are willing to supply at the Maximum and minimum starting point prices. The number of tranches bid at the Maximum starting price determines eligibility for the auction. As long as the initial number of bids exceeds what is needed, a lower price is stated for the next round of bidding, and so on. Suppliers change the number of tranches they are willing to supply in each successive round with each new price, continuing until the number of tranches needing to be supplied is achieved.[17]

Typical term of the BGS supply obligation has been 12-month for BGS-CIEP and a blend of 12-month (2/3) and 36-month (1/3) for BGS-FP.

Results

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[15] Extracted from NJBPU Order in Docket Nos. EX01050303 et al., issued 2/4/02.
[16] NJBPU Order in Docket Nos. EX01110754 and EO02070384, issued 11/20/02, p.4.
[17] A more complete description of the auction structure and process is provided in: NJBPU Decision and Order in Docket Nos. EX01050303, et al., issued 12/10/01, pp. 3-6.

Results of NJ's descending clock auctions for BGS power supply have been judged successful by the NJBPU based on its stated certification criteria, and to date all tranches included in the auctions have been filled. Resulting prices have been analyzed relative to prevailing Market price trends and deemed to be reasonable.